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May 11, 1999

Ex Parte

Ms. Magalie R. Salas
Secretary
Federal Communications Commission
Room TW-A325, The Portals
445 Twelfth Street
Washington, D.C. 20554

Re: CC Docket No. 98-81, *1998 Biennial Regulatory Review – Review of Accounting and Cost Allocation Requirements*, 13 FCC Rcd 12973 (1998) ("Accounting Biennial Review NPRM").

CC Docket No. 98-117, *1998 Biennial Regulatory Review – Review of ARMIS Reporting Requirements*, 13 FCC Rcd 13695 (1998) ("ARMIS Biennial Review NPRM").

ASD File No. 98-43, *Petition for Forbearance of the Independent Telephone and Telecommunications Alliance*, filed February 17, 1998.

Dear Ms. Salas:

On April 22, 1999, the Independent Telephone & Telecommunications Alliance ("ITTA") filed a paper (the "Paper") prepared by Parrish, Blessing & Associates, Inc. ("PBA") regarding "Differences Between Mid-Size and Large Local Exchange Carriers and the Resulting Regulatory and Competitive Implications." In this Paper, PBA argues that the differences between mid-sized and large incumbent local exchange carriers ("ILECs") justify "more aggressive deregulatory policies" for the mid-sized ILECs. While SBC Communications Inc. ("SBC") fully supports meaningful deregulatory measures, SBC believes that the relief sought by ITTA in its Forbearance Petition should apply equally to mid-sized and large companies alike.[1] That is, the FCC should reduce the burden of its regulation across-the-board. When all of the differences between mid-sized and large ILECs are fully considered, including the fact that large ILECs are subject to price cap regulation, it becomes clear that mid-sized and large ILECs are equally entitled to relief from costly and burdensome accounting and reporting requirements.

[1] Of course, small ILECs are not subject to most of the requirements addressed in the Forbearance Petition. Thus, small ILEC regulation is not considered here.

In the above-referenced NPRMs, the FCC proposed special relief from accounting and reporting requirements for mid-sized ILECs primarily based on the belief that mid-sized ILECs typically have a lower volume of transactions involving competitive products and services than the large ILECs, and thus, have fewer opportunities to cross-subsidize these products and services at ratepayer expense.[2] Even the mid-sized ILECs, in the comments filed by the ITTA, disagreed with the FCC's assumption regarding the relative volume of competitive and nonregulated activity.[3] And other commenters showed that the mid-sized ILECs typically report a significantly larger percentage of nonregulated activity in their ARMIS reports.[4]

The Paper attempts to furnish new bases for giving mid-sized ILECs preferential relief from a host of redundant and costly regulatory restrictions by claiming that there are several differences between mid-sized and large ILECs that justify applying a different, streamlined set of regulations to the former. For example, the Paper alleges that, compared to the large ILECs, mid-sized ILECs:

(1) have a higher average cost per line, although they are allegedly more efficient in serving small exchanges;

(2) deploy advanced technology more rapidly; and

(3) mainly serve rural areas, which are not receiving the anticipated benefits of local competition.

The Paper contends that, using a cost/benefit approach, these differences justify elimination of regulations such as the affiliate transaction rules. However, a complete analysis of regulatory relief should consider the circumstances of large ILECs that are not considered in the Paper. The Paper argues for significant relaxation of current regulations for the mid-sized ILECs, prior to any relief for the large, price cap ILECs, without considering the purposes that the regulation was intended to achieve and its current value in achieving those purposes. In order to completely weigh the costs against the benefits, any analysis of the degree of deregulation should evaluate the benefits of a given regulation in terms of its original purposes. However, except for references to a few broad areas of regulation and several references to the affiliate transaction rules, the Paper does not even identify the regulations that it argues should be streamlined or relaxed for the mid-sized ILECs. To complete the analysis, the FCC should consider this aspect of the issue to reach a balanced result.

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[2] Accounting Biennial Review NPRM, 12 FCC Rcd at 12974-81; ARMIS Biennial Review NPRM, 12 FCC Rcd at 13698-13702.

[3] ITTA Comments, CC Docket No. 98-81, filed July 17, 1998, at 3-4 ("ITTA must disagree with the Commission's assertion that midsize companies face lower levels of competition or engage in 'lower volumes' of competitive transactions.").

[4] *See, e.g.,* SBC Comments, CC Docket No. 98-81, filed July 17, 1998, at 9-10 & Exhibit 2; USTA Comments, CC Docket No. 98-81, filed July 17, 1998, at 7-8.

The Paper's analysis needs to be supplemented in another respect because one should consider other important differences between large and mid-sized ILECs.[5] Most importantly, while all of the large ILECs are subject to price cap regulation, virtually all of the mid-sized ILECs are still governed by cost-based, rate-of-return regulation. This difference is critical to this comparative analysis because many of the regulations from which the mid-sized ILECs want special relief were adopted under rate-of-return regulation. Since there is little, if any, benefit in continuing to apply these regulations to price cap ILECs, especially now that the sharing mechanism has been eliminated, it is clear that at least as much regulatory relief is justified for the price cap ILECs as for the mid-sized ILECs.

Most of the large ILECs also face a greater level of local exchange and exchange access competition than the mid-sized ILECs because they are most heavily concentrated in the large metropolitan areas where local competition is most intense. The existence of greater competition is another factor that tends to reduce the need for regulatory oversight of the large ILECs to a greater extent than in the case of the mid-sized ILECs. While the Paper acknowledges the discipline that a competitive market provides,[6] it does not fully consider that the need for regulation is less in the large metropolitan markets served mainly by the large ILECs where there is a greater degree of local competition. Such a comparison is essential in any analysis of the need for accounting and reporting regulation, the end result of which should be a conclusion that both groups deserve the same degree of regulatory relief.

The bottom line is that the circumstances of the large ILECs provide just as much, if not more, justification for relief from accounting and reporting regulation as those of the mid-sized ILECs. That is, when all the differences are considered, the reasonable course of action would be to give all telephone companies, small, mid-sized and large, the same relief from accounting, reporting and other regulations. No particular group is more deserving of relief than any other. While the Paper identifies a number of differences, the real issue is whether those differences are significant in terms of the purpose of the regulation the FCC is considering streamlining or eliminating as part of its Biennial Review. And, from that perspective, one should consider the very important difference between the form of regulation of mid-sized and large ILECs. While the burden that these regulations impose on mid-sized ILECs may be significantly larger on a per-line basis than for the large ILECs (and that alone justifies relief for the mid-sized ILECs), mid-sized ILECs are still motivated primarily by cost recovery mechanisms whereas price cap regulation without sharing substantially reduces the significance of costs. Therefore, there is as much justification for eliminating the accounting, cost allocation and reporting requirements for price cap ILECs as for the mid-sized ILECs.

In any event, it is true that many regulations, such as the Class A system of accounts and the property recordkeeping requirements, are much more complicated and burdensome than reasonably necessary to accomplish what little remains of their original purposes,

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[5] *Id.* at 11-17.
[6] Paper at V-7 to V-10.

even as applied to rate-of-return carriers. This is true for mid-sized ILECs when the costs of regulation are measured on a per-line basis and it is also true of large ILECs, such as SBC which spends over $50 million a year simply to keep track of property records and associated requirements. As the Paper correctly observes, when the barriers to entry have been removed, as they have been in the local exchange industry, an immediate reduction of regulation should occur.[7] However, reducing regulation on a piecemeal basis for one group of carriers would not recognize the significant justifications for across-the-board relief. The Paper also correctly observes that the FCC has increased the number of regulations since passage of the 1996 Act.[8] Creating another category of carriers eligible for special regulatory treatment would require the FCC to adopt different regulations for the mid-sized ILECs.[9] This would lead to a more complex set of regulations. It would be much simpler, and more consistent with a complete evaluation of the relative merits of the circumstances of the two groups, to eliminate or relax regulation across-the-board for both the mid-sized and the large ILECs.

Using one of the few specific requirements mentioned in the Paper – the affiliate transaction rules[10] – we can see how the Paper provides justification for eliminating or relaxing regulation for mid-sized ILECs, but does not consider that large ILECs are equally deserving of the same relief, primarily due to price cap regulation. Thus, to the extent that the Paper seeks relief for mid-sized ILECs long before any relief for large ILECs, the Paper's analysis is incomplete and does not justify such preferential, advance relief for the mid-sized ILECS alone. In describing the direct and indirect costs of regulation, the Paper contends that regulations such as the affiliate transaction rules have a disproportionate impact on mid-sized ILECs and restrict competitive development. The Paper reasons that eliminating these regulations would stimulate mid-sized ILEC competitive entry into other small markets[11] and accelerate deployment of advanced technology to rural markets.[12] While the Paper identifies several direct and indirect costs of continued regulation of mid-sized ILECs, a complete analysis requires an evaluation of the purposes of regulations such as the affiliate transaction rules and the value of these rules in achieving their purpose. Instead, on the "benefit" side of the cost/benefit analysis, all the Paper says is that "other existing safeguards provide the same protection" as the

[7] *Id.* at V-7 to V-10.

[8] *Id.* at VII-5.

[9] *Id.* at VII-3 ("This may entail the FCC adopting different regulations for the smaller carriers in recognition of their differences from the large companies . . ..")

[10] While the Paper states that there are many redundant and costly regulations that should be eliminated or streamlined, it identifies the affiliate transaction rules as being "chief among these restrictions." Paper at II-5. *See also* Paper at V-10, VI-3 ("most notably the affiliate transaction rules") and VII-6. We assume the Paper is referring to Section 32.27 of the FCC's Rules, but this is not clear.

[11] Paper at VI-3.

[12] *Id.* at VII-2.

affiliate transaction rules.[13] However, the Paper never specifically identifies which other safeguards would provide the same protection, much less explain how they provide the same protection. It is true that there are other safeguards, and these other safeguards need to be considered in a complete analysis. For a complete cost/benefit analysis, which the Paper acknowledges is the proper approach,[14] one should consider how other safeguards render the affiliate transaction rules unnecessary, and thus, how the balance would tip in favor of eliminating the regulation. For instance, in the case of the large ILECs price cap regulation provides an effective protection against large ILEC ratepayer cross-subsidy of affiliates.

While the mid-sized ILECs have a legitimate reason to expect the FCC to consider the impact of future regulations on mid-sized ILECs in view of their circumstances as a group, a complete analysis of the need for accounting and reporting requirments needs to consider the whole picture, which justifies relief for large ILECs the same as for the mid-sized ILECs. Some of the theories in the Paper require further analysis as applied to large ILECs before any solid conclusions could be reached on how to proceed with deregulation. While this brief letter is not intended to provide a comprehensive analysis,[15] SBC does recommend that the FCC proceed with caution, in a manner that gives a fair and balanced consideration to the circumstances of all the ILECs.

The Common Carrier Bureau recently announced a process for it to undertake a comprehensive review of those accounting and reporting requirements that remain after completion of the 1998 Biennial Review.[16] The comprehensive review is a significant step in the right direction and may represent the best opportunity for meaningful simplification of costly and burdensome rate-of-return era accounting and reporting regulation for all telephone companies. SBC encourages the FCC to focus its efforts on the Biennial Review and on the comprehensive review that has just begun. Therefore, for the reasons explained above and in SBC's comments on the above-referenced NPRMs, SBC urges the FCC to adopt regulatory relief across-the-board for all ILECs to the fullest extent possible at each stage of the FCC's review process. For the mid-sized ILECs relief is justified based on the heavier burden that the regulations impose (such as on an average cost per line basis); whereas for the large ILECs, factors such as price cap regulation and the higher degree of local competition justify similar relief from costly and burdensome accounting and reporting regulation.

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[13] *Id.* at VI-3 & VII-6.

[14] *Id.* at I-1 to I-2 ("Ultimately, to determine whether a regulation advances the public interest, it should be examined to determine whether its benefits exceed its costs.")

[15] SBC does not necessarily agree with all of the conclusions and analysis in the Paper, but, in the interest of brevity, SBC is not undertaking a complete review of the Paper in this letter. For example, SBC has not evaluated the Paper's statistical analysis and does not necessarily agree with all of the implications of this analysis described in the Paper.

[16] Public Notice, Common Carrier Bureau Announces Initiative To Undertake Comprehensive Review of Part 32 and ARMIS Requirements, DA 99-695, released April 12, 1999.

One original and one copy of this letter are being submitted. Please include a copy of this letter in the record of the above-referenced proceedings in accordance with Section 1.1206(a)(2) of the FCC's Rules.

If you have any questions, please do not hesitate to contact Ms. Jeannie Fry at 202-326-8894 or the undersigned.

Sincerely,

B. Jeannie Fry

cc: Mr. Ken Moran, Chief, Accounting Safeguards Division
Mr. Tim Peterson, Assistant Chief, Accounting Safeguards Division
Ms. Lisa Zaina, Deputy Chief, Common Carrier Bureau
Office of Chairman William Kennard
Office of Commissioner Furchtgott-Roth
Office of Commissioner Ness
Office of Commissioner Powell
Office of Commissioner Tristani